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No.09-1023

IN THE
Supreme Court of the United States

APEX OIL COMPANY, INC.,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

REPLY BRIEF FOR THE PETITIONER

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TABLE OF CONTENTS

TABLE OF CONTENTS i
TABLE OF AUTHORITIES ii
REPLY BRIEF FOR THE PETITIONER 1
CONCLUSION 12

TABLE OF AUTHORITIES

Cases

FCC v. NextWave Pers. Commc'ns, Inc.,
537 U.S. 293 (2002) 4

In re Chateaugay Corp.,
944 F.2d 997 (2d Cir. 1991) 2, 5

In re Davis,
3 F.3d 113 (5th Cir. 1993) 8

In re Grossmans, Inc.,
No. 09-1563 (3d Cir. June 2, 2010) 8

In re Kaiser Aluminum Corp.,
No. 09-1482 (3d Cir. July 8, 2010) 9

In re Piper Aircraft, Corp.,
58 F.3d 1573 (11th Cir. 1995) 8

In re Torwico Elecs.,
8 F.3d 146 (3d Cir. 1993), *cert. denied*, 511
U.S. 1046 (1994) 2, 4, 10

In re Zilog, Inc.,
450 F.3d 996 (9th Cir. 2006) 8

Johnson v. Home State Bank,
501 U.S. 78 (1991) 4

Kennedy v. Medicap Pharms., Inc.,
267 F.3d 493 (6th Cir. 2001) 2

Lemelle v. Universal Mfg. Corp.,
18 F.3d 1268 (5th Cir. 1994) 8

Ohio v. Kovacs,
469 U.S. 274 (1985) ..... *passim*

Pennsylvania Dep't of Pub. Welfare v. Davenport,
495 U.S. 552 (1990) 4

United States v. Whizco,
841 F.2d 147 (6th Cir. 1988) 2, 4, 10, 11

Statutes

11 U.S.C. § 101(5)(B) 1, 7, 8

11 U.S.C. § 523 4

Resource Conservation and Recovery Act of 1976, 42 U.S.C § 6901, *et seq.* ..... *passim*

Other Authorities

Brian Rosenthal, *When a Discharge Isn't*, American College of Environmental Lawyers, *available at* http://www.acoel.org/2010/03/articles/hazardous-materials/when-a-discharge-isnt/ 9

Judicial Materials

Brief in Opposition, *Torwico Electronics v. State of New Jersey*, 1994 WL 16100299 (Sup. Ct. 1994) (No. 93-1187) 10

Fed. R. Civ. P. 70 7

REPLY BRIEF FOR THE PETITIONER

The Bankruptcy Code provides that a "right to an equitable remedy for breach of performance" – such as an injunction – is a "claim" discharged in bankruptcy, so long as "such breach gives rise to a right to payment." 11 U.S.C. § 101(5)(B). In this case, the government seeks to enforce an environmental clean-up injunction that may require petitioner to expend an estimated $150 million. The government further contends that if petitioner fails to comply, it can be required to make an out-of-pocket "payment" of the costs of a clean-up undertaken by either the United States or a receiver. The question whether the clean-up obligation is nonetheless not a "claim" is the subject of a square and widely acknowledged circuit conflict over how to interpret this Court's decision in *Ohio v. Kovacs*, 469 U.S. 274 (1985). The present profound uncertainty in the law calls into question the viability of all of the thousands of debtors that have potential environmental liabilities. No reasonable investor will invest new capital in such a reorganizing entity in these circumstances because, as this case illustrates perfectly, the investment is subject to later being seized at the whim of the regulatory agency, notwithstanding the clean slate supposedly provided by the reorganization. Certiorari is accordingly plainly warranted.

1. The square circuit conflict over the question presented has been expressly recognized by the Seventh Circuit (Pet. App. 6a-7a), by numerous commentators (*see* Pet. 29), and now by the Solicitor General (BIO 16). Whether an injunction requiring the clean-up of existing pollution is discharged in

bankruptcy depends entirely on the jurisdiction in which the case happens to arise – a circumstance that is an open invitation to forum shopping. In any given case, indistinguishable injunctions will be always dischargeable to the extent they require the expenditure of money (*United States v. Whizco*, 841 F.2d 147 (6th Cir. 1988)); never dischargeable (*In re Torwico Elecs.*, 8 F.3d 146 (3d Cir. 1993), *cert. denied*, 511 U.S. 1046 (1994); *In re Chateaugay Corp.*, 944 F.2d 997 (2d Cir. 1991)); or dischargeable *if* the debtor can be required to pay for the clean-up in the event of non-compliance (Pet. App. 3a-4a, 8a).

a. Petitioner would prevail under the holding of the Sixth Circuit that an environmental clean-up injunction always gives rise to a "claim" to the extent it requires the debtor to make "payment[s]" through the expenditure of money, because those costs deplete the debtor's estate just as surely as would a money judgment. *United States v. Whizco, Inc.*, 841 F.2d 147, 150-51 (6th Cir. 1988). But it does not follow from the Sixth Circuit's holding that *every* injunction would be deemed dischargeable (*contra* BIO 18-19), because the many equitable obligations that do not require the expenditure of funds – such as an injunction enforcing a non-compete obligation – are not "claims." *Kennedy v. Medicap Pharms., Inc.*, 267 F.3d 493, 497 (6th Cir. 2001).

The Sixth Circuit's ruling in *Whizco* derives significant support from *Kovacs*, in which the state secured both an order requiring the debtor to cease polluting and an injunction requiring an environmental clean-up. When the debtor failed to comply with the injunction, the government had no right to an out-of-pocket payment. Instead, it used

its ordinary civil remedies to secure the appointment of a receiver to conduct the clean-up with the debtor's resources. This Court unanimously held that the injunction – which, unlike the order requiring the debtor not to pollute, required the expenditure of money – was a dischargeable claim. *See Kovacs*, 469 U.S. at 281. *Kovacs* thus embraced the lower courts' reasoning in that case that the injunction was a dischargeable claim because the debtor could not "render performance under the affirmative obligation [*i.e.*, the injunction] other than by the payment of money." *Id.*

Nor was the role of the receiver otherwise critical in *Kovacs*. This Court took care to specify repeatedly that the "obligation under the injunction" – not merely the later-arising financial obligation to the receiver on which the government rests its position – was the dischargeable "claim" in that case. 469 U.S. at 275, 277.

Kovacs illustrates that the role of the definition of "claim" is to identify significant burdens that may deplete the estate and thus preclude the fresh start that is a defining feature of chapter 11 reorganizations. The identical burden exists *whenever* the debtor may be forced to pay for a clean-up – whether that payment involves the financial drain of hiring contractors to comply with an injunction in the first instance, or instead subsequently paying costs when the government or a receiver performs the clean-up. There is no reason that the Code would treat the two circumstances differently. *See* Pet. 21.

The government's contention that its contrary position is supported by the "narrow" reading of

"claim" embraced by this Court in *Kovacs* (BIO 12) fails to acknowledge that this Court has repeatedly held precisely the opposite, holding that "Congress intended . . . to adopt the *broadest available* definition of 'claim.'" *Johnson v. Home State Bank*, 501 U.S. 78, 83 (1991) (emphasis added). *See also FCC v. NextWave Pers. Commc'ns, Inc.*, 537 U.S. 293, 302 (2002); *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 559 (1990); Pet. 26. If Congress had in fact intended to exclude environmental clean-up injunctions from discharge in bankruptcy, it would have included them among the express exceptions to discharge. *See* Pet. 25; 11 U.S.C. § 523.

The Sixth Circuit's decision in *Whizco* cannot be distinguished on the ground that the debtor in that case was an individual whereas petitioner is a corporation. *Contra* BIO 20. The government itself admits that the attempt to limit *Whizco* in that fashion has been explicitly rejected. *See* BIO 20 n.11. The reason is obvious: imposing different rules would fly in the face of the text and structure of the Bankruptcy Code, because the relevant statutory provisions apply to individuals and corporations *identically*. One need look no further than *Kovacs*, which involved an individual debtor, yet every court (and the United States itself) recognizes that this Court's decision applies equally in the context of corporate reorganizations like this one.

b. At the opposite extreme, the Second and Third Circuits hold that an order to clean up existing pollution is never a dischargeable claim. *See* Pet. 30 (discussing *In re Torwico Elecs.*, 8 F.3d 146, 151 (3d Cir. 1993), *cert. denied*, 511 U.S. 1046 (1994); *In re*

Chateaugay Corp., 944 F.2d 997, 1008 (2d Cir. 1991)). The government now embraces their reasoning, arguing that "petitioner's breach of its environmental-law obligations does not give the United States . . . a 'right to payment'" because "RCRA does not authorize the United States to seek a monetary remedy *in place of* an equitable remedy." BIO 8 (emphasis added). But that is precisely the argument made by Ohio and the United States, and unanimously rejected by this Court, in *Kovacs*. In that case, the respondent was ordered to clean up existing pollution, and the state "had no right to, and was not attempting to enforce, an *alternative* right to payment." 469 U.S. at 282 (emphasis added).

c. The Seventh Circuit staked out a middle-ground interpretation of "claim," holding that whether a clean-up injunction constitutes a "claim" turns on whether the government can secure an order requiring a non-compliant party to pay the costs of the clean-up. "[D]ischarge must indeed be limited to cases in which the claim gives rise to a right to payment because the equitable decree cannot be executed, rather than merely imposing a cost on the defendant, as virtually all equitable decrees do." Pet. App. 8a.

The court of appeals held that the injunction in this case is not dischargeable because – as the court of appeals understood the government's rights – the government may *never* secure monetary relief in a case under RCRA:

> But the Resource Conservation and Recovery Act, which is the basis of the government's equitable claim, does not entitle a plaintiff to demand, in lieu of action by the defendant

> that may include the hiring of another firm to perform a clean up ordered by the court, payment of clean-up costs. It does not authorize *any* form of monetary relief.
>
> * * * *
>
> Thus the government's equitable claim, if well founded, as the district court ruled it to be, entitles the government only to require the defendant to clean up the contaminated site at the defendant's expense.

Pet. App. 3a-4a (emphasis in original).

But the United States now rejects the Seventh Circuit's intermediate position. On its view, petitioner should *prevail* under the rule announced by the court of appeals in this case, because the Solicitor General identifies two independent bases for requiring a non-compliant party to make a "payment" for the costs of the clean-up: if the government does the clean-up itself, "then the government can recover from petitioner the money that the government expended" (BIO 15); alternatively, as in *Kovacs*, the government may secure "the appointment of a receiver" to conduct the clean-up directly with the party's funds (*id.* 11; *see also* Pet. 8). (The government seemingly disavows yet a third path to securing a monetary award – a cost-recovery action directly under RCRA – but the brief in opposition is too opaque to be sure. *Compare* Pet. 22 *with* BIO 13-15.)

The government's own articulation of its rights and remedies proves that the judgment in this case conflicts with *Kovacs*. The statutes in the two cases are indistinguishable – a point the Solicitor General

frankly admitted in *Kovacs* (*see* Pet. 10) and the brief in opposition now only reinforces. Under both, the government may "seek an order requiring [the private party] to clean up the contaminated site." BIO 14 (RCRA); *Kovacs*, 469 U.S. at 278-79 (Ohio law). Only if the party violates that injunction may the government "seek the appointment of a receiver" to conduct the clean-up directly with the party's funds. BIO 11 (FRCP 70); *Kovacs*, 469 U.S. at 282 (Ohio law). *See generally* Pet. 7-8. The only difference between the statutes is that RCRA grants the United States an *additional* "right to payment" (11 U.S.C. § 101(5)(B)) that Ohio *didn't* have in *Kovacs*: "if the United States undertakes the required cleanup, then the government can recover from [the party] the money that the government expended." BIO 15.

Seemingly recognizing that the statutes cannot be distinguished, the government makes a single desperate attempt to argue that *Kovacs* turned on "the sequence of events." BIO 12. The government asserts that it "was critical" in *Kovacs* that "the State of Ohio had abandoned any effort to enforce a non-monetary remedy before the bankruptcy was initiated," whereas when petitioner's corporate predecessor declared bankruptcy "the United States [had] not abandoned its right to the equitable decree entered by the district court." BIO 12.

Even a moment's thought demonstrates that the existence of a "claim" cannot depend on whether the creditor has made the self-interested determination to invoke its "right to payment." The Code by its terms recognizes that an equitable right which also "gives rise" to a right of payment is a "claim" without

regard to whether that right is "contingent" (as in this case) or "matured" (as in *Kovacs*). 11 U.S.C. § 101(5)(B). The Seventh Circuit made this very point: "The natural reading of the [definition of 'claim'] is that if the holder of an equitable claim can, *in the event* that the equitable remedy turns out to be unobtainable, obtain a money judgment instead, the claim is dischargeable." Pet. App. 2a-3a (emphasis added). Courts recognizing the dischargeability of equitable claims – including the Seventh Circuit in this very case – uniformly look to whether a right to payment could arise, not whether the creditor has invoked its right to payment at the time of bankruptcy. Pet. App. 3a (discussing "a decree of specific performance" to sell certain property backed by the right "to a money judgment for the value of the property" in the event the sale was not made (citing *In re Davis*, 3 F.3d 113, 116 (5th Cir. 1993)); *see also, e.g.*, *In re Grossmans, Inc.*, No. 09-1563, at 18 (3d Cir. June 2, 2010); *In re Zilog, Inc.*, 450 F.3d 996, 999-1000 (9th Cir. 2006); *In re Piper Aircraft, Corp.*, 58 F.3d 1573, 1576-77 (11th Cir. 1995); *Lemelle v. Universal Mfg. Corp.*, 18 F.3d 1268, 1277 (5th Cir. 1994).

Congress cannot plausibly have intended to adopt the government's contrary view, which would undercut the effectiveness of the environmental laws by creating a perverse incentive for regulatory agencies to defer enforcement actions. *See* Pet. 19. Conversely, the government's position creates a perverse incentive for debtors to ignore directives from environmental regulatory agencies until the agency obtains the appointment of a receiver or cleans up a site itself and seeks to recover costs,

because the liabilities arising from such processes would be dischargeable in contrast to the agencies' directives. More broadly, the government's position would permit creditors of all types – well beyond the environmental context – to game the bankruptcy system by deferring the enforcement of their monetary rights until after the date of a bankruptcy filing.

e. The circuit conflict is moreover intolerable. The Petition demonstrated the tremendous importance of the question presented, particularly in an era of dramatically expanding corporate insolvency. The United States, which is regularly a party to bankruptcies involving environmental claims, conspicuously does not dispute the Petition's showing that the issue arises constantly in proceedings around the country. *See* Pet. 25-26. That is not surprising, given the billions of dollars in liability that the government asserts under RCRA and other environmental statutes. *See also, e.g., In re Kaiser Aluminum Corp.*, No. 09-1482 (3d Cir. July 8, 2010) (remanding for assessment of whether causes of action under state environmental law are dischargeable claims). As the distinguished American College of Environmental Lawyers has opined, the ruling below is "very important" and will "reverberate around the country for years to come." Brian Rosenthal, *When a Discharge Isn't, available at* http://www.acoel.org/2010/03/articles/hazardous-materials/when-a-discharge-isnt/ (last checked July 21, 2010).

Moreover, the unresolved conflict creates a severe "off-the-balance-sheets" uncertainty for reorganized entities by interjecting a liability that may be

asserted years after a bankruptcy court grants the entity a full discharge. Investors will be unlikely to provide the financing that makes the reorganization of such an entity possible because, at any time, a regulatory agency may assert a clean-up liability and require the expenditure of all of the reorganized entity's newly invested capital and newly earned profits. Corporate reorganizations, which preserve jobs and the going-concern value of enterprises, will become impractical and debtors will choose instead to liquidate. As Justice O'Connor explained in *Kovacs* itself, the government is thus cutting off its nose to spite its face. *See* 469 U.S. at 285-86; Pet. 24-25.

This is also the ideal vehicle in which to resolve the question presented. The Seventh Circuit squarely decided the issue, which is dispositive of the case. The Solicitor General fails to acknowledge that in *Torwico, supra*, by contrast, the issue was "hypothetical" because "the debtor ha[d] sold its business, ha[d] ceased operating, and [was] liquidating." BIO 8, *Torwico Elecs. v. New Jersey*, No. 93-1187. *See also id.* 26 ("Petitioner talks about not thwarting a debtor's reorganization, but in this matter, the debtor is *not* reorganizing – it has sold its business and is liquidating – and therefore *nothing* is dischargeable." (emphases in original)). Moreover, whereas the Third Circuit decided *Torwico* relatively soon after the Sixth Circuit's decision in *Whizco*, fifteen further years have now since passed, establishing that the conflict will not be resolved without this Court's intervention.

The fact that other courts of appeals have adopted two other, mutually inconsistent rules rather than joining the Sixth Circuit (BIO 17) is a reason to

grant review, not deny it. The relevant conclusion to be drawn from "the 22 years since *Whizco* was decided" (*ibid.*) is thus that the Sixth Circuit has never retreated from its ruling in that case, and the government does not even attempt to offer any reason to hope it ever will. Equally important, the Seventh Circuit will surely adhere to the interpretation of "claim" that the Solicitor General rejects in the brief in opposition. There is accordingly no prospect that federal law will return to the state of uniformity and clarity that is uniquely important in the context of corporate reorganizations absent this Court's intervention.

2. The remaining arguments of the United States for distinguishing *Kovacs* are unpersuasive.

The government's passing assertion that *Kovacs* can be distinguished on its facts because "this Court . . . found" that "the *State of Ohio* . . . had sought 'only a monetary payment' from" Kovacs (BIO 9 (quoting 469 U.S. at 277) (emphasis added)) is totally invented. The language quoted by the Solicitor General actually describes the reasoning of "the Sixth Circuit." 469 U.S. at 277. By contrast, "this Court" correctly recognized that no payment was made to or sought by Ohio; instead, "[w]hat *the receiver* wanted from Kovacs after bankruptcy was the money to defray cleanup costs." *Id.* at 283 (emphasis added).

The government also errs in suggesting that *Kovacs* can be distinguished on the ground that in this case "petitioner has access to the source of the contamination." BIO 11. Because it is undisputed that petitioner does not own either the refinery site or (with trivial exceptions) any of the vast property to be cleaned up under the injunction (*see* Pet. 8), the

government must mean that petitioner has the right to ask for permission to enter that property. That is true, but it was surely just as true in *Kovacs*, where there is no reason to believe that the receiver would have refused an offer by the debtor to participate in the clean-up. Equally important, "access" is a concept that is completely foreign to the Bankruptcy Code, which instead asks whether the government holds an equitable right that may give rise to a right to payment. *Kovacs* answers that question "yes."

CONCLUSION

For the foregoing reasons, as well as those set forth in the Petition, certiorari should be granted.

Respectfully submitted,

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